October 31, 1991

COORDINATED ISSUE
COMMERCIAL BANKING
CORE DEPOSIT INTANGIBLES

ISSUE

Should the excess purchase price paid for a bank over the tangible assets acquired be treated as goodwill/going concern value or as an amortizable intangible asset called core deposit intangible?

RECOMMENDED POSITION

As a general rule the core deposit intangible is indistinguishable from goodwill/going concern value.

FACTS, LAW AND ARGUMENT

The Office of the Comptroller of the Currency (O.C.C.) issued circular #164 on December 29, 1981 which provides that national banks could, under appropriate circumstances, capitalize and amortize the value of the customer deposit relationships. A similar policy was adopted by the FDIC on March 5, 1982. Banks intending to record such assets must obtain prior approval from the Comptroller of the Currency and the S.E.C.

The O.C.C. defines Core Deposits as the deposit base of demand and savings accounts which, while usually not legally restricted, are generally based on stable customer relationships that the bank can expect to maintain for an extensive period of time, often many years. Jumbo certificates of deposit ($100,000. denomination or more) are normally excluded from the definition as they are considered more indicative of a borrower rather than customer relationship.

The Core deposit intangible is the present value of the future net income stream associated with a Bank's deposit.

Accountants characterized goodwill as the potential of a business to earn above normal profits. Conceptually, goodwill is the present value of the expected future excess earnings. Goodwill arises as a result of such factors as customer acceptance, efficiency of operation, location, internal competency and financial standing.

In Herndon v. Commissioner, 21 TCM (1962), the Tax Court stated that "goodwill" may refer to the expectation that customers of an established business will continue their patronage.

"Going concern value" is related to the ability of an established business, fully equipped and staffed, to generate earnings without interruption because of a change in ownership (Winn-Dixie Montgomery Inc. v. United States 444 F. 2d 667-5the cir. 1971). It is an intangible asset that exists as a value enhancement for the assemblage of a business and is not depreciable. (Cornish Et al v. United States, 348 F. 2d 1975).

In Rev Rul 74-456,the government held that, generally, customer and subscription lists (when considered as mass, indivisible assets) location contracts, insurance expirations, etc., represent the customers structure of business whose value last until an indeterminate time in the future. Such assets are in the nature of goodwill or otherwise have indeterminate lives. The ruling assumes that a mass asset is really one asset the loss of any part of which is offset in a continuing manner by additions there to; the "regenerative theory". It should be noted that bankers themselves liken core deposit to customers list.

In First National Bank of Omaha v. Commissioner, T. C. memo 1975-67,. the Court in its citation of First Pennsylvania Banking and Trust Co., 56 TC 677, noted: "If, however, the purchaser has not paid for mortgage servicing rights but rather has purchased goodwill, going concern value, business organizations, investor and borrower relationships, (emphasis added) opportunities for future business and income and similar intangibles, he is not entitled to a deduction for amortization".

In contrast, in Midlantic National Bank v. Commissioner, 46 TC 1464, the Tax Court factually determined that no goodwill or going concern value was acquired in the transaction and that the solicitation right acquired from the FDIC was a separate asset. But in this case, the acquiror bid for the right to solicit the failed bank's depositors as they were being paid off by the FDIC. As accounts attributable to the solicitation rights were closed, the taxpayer deducted amounts allocated to that account. The court essentially treated the solicitation rights as customer lists where amortization may be allowed. However, the treatment of costs to acquire the right to solicit the former depositors of a failed bank in order to develop a new deposit base must be distinguished from the treatment of costs incurred to acquire a pre-existing deposit base of both a going concern bank and, in most cases, of a failing bank where the doors never close but the signs of ownership merely change from one day to the next. Here, none of the amount paid to acquire the deposit base would be depreciable because there is no wasting asset in an on going stream of customers and their deposits.

In Southern Bancorporation Inc. v. United States (4the cir 1984) the circuit court rejected the taxpayer's post hoc upward revaluation of the loan portfolio it acquired and found the premium paid to acquire a failing bank was attributable to its going concern value. Although the bid was figured as a percentage of the largest deposits, the taxpayer did not pursue its argument that it acquired "cheap money", which it believed

was an amortizable asset.

The Court noted that the taxpayer had failed to show that it intended to pay an enhanced value for the loan portfolio at the time of acquisition. The court was persuaded by the evidence offered by the government which indicated that the loans in aggregate were worth less, not more, than face, and that the premium was paid to obtain the going concern value of the largest branches.

In Banc One (84 TC 476; Dec.41, 985), the Court rejected the taxpayer's method of estimating the useful life of the core deposits primarily because the information relied upon by the taxpayer to compute the deposit lives was based upon hindsight. The deposit base studies submitted by the taxpayer relied upon events occurring after the date of acquisition and, therefore, post hoc valuations of the core deposit base could find no legal support for amortization. Although the Court did recognize that reasonable approximations are appropriate in establishing the useful life of an asset, the data used must be contemporaneous and not post hoc. No opinion was expressed, therefore, as to whether core deposit intangibles are properly amortizable since the issue was otherwise decided.

CONCLUSION

Based on the cited authorities our position should be that the so called core deposit intangible is not sufficiently distinguishable from goodwill/going concern value to allow a deduction for amortization.